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In the Supreme Court of the United States.

OCTOBER TERM, 1924

CHARLES V. DUFFY, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIFTH DISTRICT OF NEW JERSEY, petitioner
v.
THE CENTRAL RAILROAD COMPANY OF NEW JERSEY

No. 129

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE PETITIONER

STATEMENT

This writ of certiorari brings up for review a decision of the Circuit Court of Appeals for the Third Circuit, affirming a judgment of the United States District Court for the District of New Jersey, made after findings of fact, awarding to The Central Railroad Company of New Jersey $70,980.03, a portion of the income taxes assessed against it for the calendar year 1916, under the Revenue Act of September 8, 1916, ch. 463, Title I, Part II, section 12 (a), 39 Stat.

767, and paid under protest by the taxpayer. The award also included interest, bringing the total judgment up to $91,812.66.

The cause was submitted to the District Court without a jury upon an agreed statement of facts, to be found in the record at pages 4 to 15.

From the findings of fact it appears that the gross income of the taxpayer for the calendar year 1916 was $35,854,392.03 (First Finding, p. 15).

The net income as determined by the Commissioner of Internal Revenue amounted to $5,741,998.35, upon which a total tax was assessed and paid of $152,621.31 (Second Finding, p. 15; Ninth Finding, p. 16). The net income as determined by the District Court is $4,082,064.02 (Eighth Finding, p. 16), upon which the Government is entitled to a tax of $81,641.29 (Rec. 13). The difference in these two items of net income, $1,659,924.33, involving $70,983.03 of the total tax paid, represents certain expenditures made by the taxpayer during 1916, which the court found to be deductible under the provisions of the Revenue Act of 1916 from the net income as determined by the Commissioner of Internal Revenue.

The Circuit Court of Appeals states in its opinion (Rec. 20) that of the judgment for $70,980.03 the petitioner concedes that the taxpayer is entitled to recover $37,781.54. In explanation thereof petitioner calls attention to paragraph 8 of the agreed statement of facts, at page 13 of the record, wherein it is agreed that the total tax due on the

net income of $5,741,988.35 is $114,839.77. In paying a total tax, therefore, of $152,621.31 the taxpayer overpaid, through error in computation, $37,781.54.

During the year 1916 the taxpayer was the lessee of several branch railroads under long-term leases. Thereunder the lessee was required to maintain and keep the leased premises, together with all appurtenances thereto, in good repair and condition, and in all respects fit for use as a railroad. The taxpayer was further obligated to pay all of the expenses for maintaining the leased premises. At the termination of the leases, all improvements erected thereon by the taxpayer revert to and become the property of the lessors. Each lease also contains the usual covenant that upon default in rental or in fulfilling the covenants the lessor could terminate the lease by giving notice.

The expenditures made by the taxpayer during the year 1916 upon the properties covered by these leases are set forth alphabetically from A to E in paragraph 6 in the agreed statement of facts at pages 5 to 9 of the record.

In addition to these leases there were also leases from the city of New York of certain piers in that city, under the terms of which the lessee agreed to construct new piers and extend old piers. The terms of these leases were for a less number of years than the railroad leases. They provided that the lessor, for the failure on the part of the lessee to keep the covenants of

the leases, could determine them, in which event all the improvements erected upon the demised property would revert to and become the property of the lessor. The expenditures made under the leases last mentioned are set forth with particularity in paragraph 6 of the agreed statement of facts, alphabetically from F to J, at pages 9 to 12 of the record.

The total sum thus disbursed by the taxpayer was for (1) additions and betterments to its leased railroads and branches, (2) construction and extension of leased piers, and (3) dredging the piers (the amount spent for dredging being only $66.62).

The expenditures made by the taxpayer on its leased railroads were for the construction of new buildings, new additions and betterments to old structures, improving roadbeds, buildings, and for new bridges, new roadbeds, new tunnels, replacing old devices with new and better ones, acquiring new lands, and paving new streets. The disbursements made for these purposes are itemized in Exhibit A to the agreed statement of facts, at pages 13, 14, and 15 of the record. The unexpired terms of these leases were longer than the life of any of the improvements and, therefore, the taxpayer will get the full beneficial use of them. None of the leases, however, required the taxpayer to construct any of the above-named improvements. The expenditures made by the taxpayer under the leases granted by the city of New

York were for the construction of new piers and extension of old piers. These leases did not require the lessee to expend any sum whatsoever during the year 1916 for additions.

The Court of Appeals in affirming the judgment of the District Court held that all of the expenditures under consideration were additional rentals; that section 12 (a), subdivision first, allowed these to be deducted within the year made, and that the provisions of article 140 of regulations 33 (revised) are inconsistent with the plain terms of the act (Rec. 23, 24).

The specific questions involved are:

First. Are these disbursements, aggregating $1,659,924.33, *capital* expenditures to be spread over the term of the lease and an aliquot part deducted in the tax return for each year or can the cost be deducted in a lump sum in the year when paid?

Second. Are the expenditures *ordinary* and *necessary* expenses which may be deducted in the year made?

Third. Are the expenditures rentals paid within the year as a condition to the continued use and possession of the leased properties and deductible in the year made, or must they be prorated in accordance with the regulations of the Treasury Department?

The taxpayer contends that the expenditures in question are rentals within the meaning of section 12 (a) of the Revenue Act of 1916, paid as a condition to the continued use and possession of the

property, and should be deducted from the gross income for the year 1916.

The petitioner contends: First, that these disbursements constitute *capital* expenditures, within the meaning of section 12 (a), Title I, Part II, of the Revenue Act of 1916 and article 132 of Regulations 33 (revised), and that, therefore, the only allowable deduction under section 12 (a), subdivision second, is an annual deduction for "depreciation." Second, that the expenditures made by the taxpayer were not *ordinary* and *necessary* expenses within the meaning of section 12 (a) of the Revenue Act of 1916. Third, that, if it be determined that the expenditures are additional rentals within the meaning of section 12 (a), first subdivision, they can not be deducted all in one year, but must be prorated over the life of the improvements, or the life of the lease, whichever is shorter, in accordance with article 140 of Regulations 33 (revised).

STATUTES AND REGULATION INVOLVED

Title I, Part II, section 12 (a), of the Revenue Act of 1916 (39 Stat. 767), provides *inter alia:*

> SEC. 12 (a). In case of a corporation, joint-stock company, or association, or insurance company organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—

First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity.

* * * * *

Second. All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear, and tear of property arising out of its use or employment in the trade; or business * * *: *Provided,* That no deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments made to increase the value of any property or estate, and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made. (39 Stat. 768.)

Article 140, Regulations 33 (revised), reads:

ART. 140. *Permanent improvements under lease.*—The cost of erecting permanent buildings, or of making permanent improvements on ground leased by a company, is held to be an additional rental and is therefore a proper deduction from gross income, provided such buildings and improvements, under the terms of the lease,

revert to the owner of the ground at the expiration of the lease. In such case, however, the cost will be prorated according to the number of years constituting the term of the lease and the annual deduction will be an aliquot part of such cost.

Article 132, Regulations 33 (revised), reads:

> *Additions and betterments.*—Amounts expended in additions and betterments, or for furniture and fixtures which constitute an increase in capital investment and add to the value of the assets, are not a proper deduction, but such expenditures when capitalized may be extinguished through annual depreciation deductions, which latter deductions will be computed upon the basis of the cost and probable life of the property.

I

All of the disbursements made by the taxpayer upon the premises occupied under the long-term leases are capital expenditures, and the only deduction allowable therefor under the Revenue Act of 1916 is an annual deduction for depreciation

The facts in this case demand that substance and not form must be considered in determining whether the items of disbursement involved are for taxing purposes, capital expenditures, or ordinary and necessary expenses or rentals.

In 1916 and for a long time prior thereto the taxpayer was in possession, as lessee, of certain properties under leases from the Lehigh & Susquehanna Railroad, the Allentown Terminal Railroad, the Ogden Mine Railroad, and the Dover &

Rockway Railroad. Each of these four leases was for a term of 999 years, commencing at a time long prior to 1916. It was also in possession of properties under a lease from the Wilkes-Barre & Scranton Railroad under a lease which ran for the length of the charter of the lessor, less one year, the charter being perpetual, but subject to alteration and repeal by the Legislature of Pennsylvania.

It is admitted under the agreed statements of fact that all of the expenditures made upon the property covered by these leases were for additions and betterments.

Technically speaking, of course, it is true that so far as the leases just mentioned are concerned the taxpayer is a lessee. But this does not mean that the payments made were rental, within the purview of section 12 (a). Indeed the admitted facts surrounding these particular leases conclusively show that the expenditures made upon these demised premises are *capital investments.* In the first place, it can not be denied that all of these improvements will eventually become a total loss by depreciation within the life of the leases which run for 999 years. This undoubtedly makes the taxpayer the *potential* owner of the properties. The reason for this conclusion is obvious. The lessors will not receive any beneficial use whatever from the improvements to the properties covered by these long-term leases, because their beneficial life will be extinguished long before the termina-

tion of the leases. In this situation, therefore, it is indeed a solecism to say that these additions and betterments constitute rental within the meaning of section 12 (a), when in fact the payments made constitute a *capital* investment to the same extent as if the taxpayer was the owner of the fee of these properties. These disbursements, therefore, partaking of the character of capital investments, can not be deducted under the *express* language of section 12 (paragraph second), which reads:

> *Provided,* That no deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments made to increase the value of any property or estate * * *.

The expenditures made under these long-term leases can not be classed as " ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties," for they were not such improvements as ordinarily recur in the operation of the taxpayer's business.

What constitutes " capital expenditures " and what constitutes " ordinary and necessary expenses " has been determined by this court in the case of *Illinois Central Railroad Co.* v. *Interstate Commerce Commission,* 206 U. S. 441, in which the following language was used at page 462:

> The findings show that the old rates were profitable and that the dividends were declared even when permanent improve-

> ments and equipment were charged to operating expenses. But may they be so charged? Appellants contend that the answer should be so obviously in the affirmative that it should be made an axiom in transportation. On principle it would seem as if the answer should be otherwise. It would seem as if *expenditures for additions, to construction and equipment, as expenditures for original construction and equipment, should be reimbursed by all of the traffic they accommodate during the period of their duration, and that improvements that will last many years should not be charged wholly against the revenue of a single year.*

Again at page 463 it is said:

> We think, it is clear, that instrumentalities which are to be used for years should *not* be *paid for by the revenues of a day or year;* and this is the principle of returns upon capital which exists in durable shape. (Italics supplied.)

The language used in section 38 of the Corporation Excise Act of 1909 (36 Stat. 112) is almost identical with section 12 (a) of the Revenue Act of 1916. In *Grand Rapids & I. Ry. Co.* v. *Doyle,* 245 Fed. Rep. 792, the question arose as to whether expenditures made for additions and betterments were "necessary expenses of the maintenance and operation of the railway property and business," and therefore deductible from the gross income under section 38 of the act of

1909. In disposing of this proposition the court at page 796 says:

> * * * Are these expenditures included in the "necessary expenses of the maintenance and operation of the plaintiff's railway property and business"? In my judgment, they are not. In each instance it is an addition to the property, and an addition to the value of the property of the railway company. It is an improvement of its property; it is an extension of its property; it is an addition not only to its inventory value but to its real and actual value.
>
> It is a well-known fact that corporations in general, both railway and manufacturing companies, often use a part of their net earnings and income in the extension and improvement of their plans and property and business. Nearly every corporation of an industrial character does that, and in many cases industrial corporations do not declare dividends for a number of years after their organization, for the very reason that they are extending and improving an addition to their property. But amounts so expended in additions are no less income than they would be if paid to the stockholders as dividends, and no less income or additions to the value than if the amount had been carried into a surplus account and placed in bank (p. 797).

As to this phase of the case, therefore, it is certain that the disbursements made upon the

property covered by these long-term leases are *capital* expenditures and, under the express terms of the Revenue Act of 1916, are not deductible in the year made, the only deduction allowed being for annual depreciation. *Union Pac. R. R. Co.* v. *United States,* 99 U. S. 402, 420; *Illinois Cent. R. R. Co.* v. *Interstate Commerce Commission,* 206 U. S. 441, 462; *United States* v. *Central Pacific R. Co.,* 138 U. S. 84; *Kemper Military School* v. *Crutchley,* 274 Fed. 125; *Union Hollywood Water Co.* v. *Carter,* 238 Fed. 329; *Walker* v. *Gulf and I. Railway Co.,* 269 Fed. 885; *Grant* v. *Hartford, etc., R. R. Co.,* 93 U. S. 225; *Haw. C. & S. Co.* v. *Tax Assessor,* 14 Haw. Rep. 601; *People* v. *Wilson,* 121 App. Div. 376, 106 N. Y. S. 1, 193 N. Y. 673; *Highland Railway Co.* v. *Balderston* (*1889*), 26 Scot. L. R. 657, 2 Gr. Br. Tax Cas. 485; *Clayton* v. *Newcastle Corp.,* 2 Gr. Br. Tax Cas. 416.

II

All of the disbursements made for additions and betterments upon the properties leased from the city of New York are capital expenditures, hence are not deductible in the year made under section 12 (a) of the Revenue Act of 1916 from the gross income for that year, but the cost should be spread over the term of the lease and an aliquot part deducted annually

The total expenditure made for additions and betterments upon the properties covered by the foregoing long-term leases amounts $114,058.79. The remaining $1,545,865.54 of the total disbursements involved in the case relate to expenditures made upon properties covered by leases

from the city of New York, and these will now be considered.

A disbursement of $1,525,308.72 was made by the taxpayer in 1916 for the construction of a new pier, known as Pier No. 9, located on property covered by a lease from the city to the taxpayer by assignment. This lease was dated January 13, 1914, and a supplement thereto was dated March 14, 1914. The term thereof was for 10 years from 1914, subject to two renewals of 10 years, and a further renewal of 9 years. There was also a further proviso for a still further extension, depending upon the total cost of the new pier. This lease provided among other things that certain land on the water front would be obtained by the city by condemnation, and when acquired the lessee was to proceed with improvements of the water front including the building of the new pier, a stone bulkhead wall, and sheds on the pier and upon the marginal street, wharf, or place extending inshore a distance of 50 feet from the bulkhead, including the filling in of the rear of the bulkhead and the paving of the street, wharf or place extending from the bulkhead line inshore to the westerly line of West Street, in accordance with plans, specifications, and estimates of costs approved by the city. The rental agreed upon was at the rate of 27½ cents per square foot per annum for the portion of the demised area not acquired from private owners

and at the rate of $1 a year for the property acquired from private owners. The lease further provided that if the entire cost of condemnation and the improvements to the taxpayer was less than $2,750,000, it was to pay in addition 5½ per cent on the difference between the $2,750,000 and the actual cost, but if the cost was more than $2,750,000 the taxpayer was to be credited on its average annual rental with 5½ per cent on the difference for a term of 39 years, the lease otherwise being for a term of 10 years, with the right of renewal, as already mentioned. The city could terminate the lease at any time after 10 years from the commencement thereof, but in case of such termination, *the city to pay such reasonable sum to the taxpayer as may be fixed by arbitrators* provided for in the lease. It also contained the usual cancellation clause, in the event of default by the lessee. (Rec. 9, 10, 11.)

With regard to this item of expenditure it is claimed by the taxpayer that it constitutes " rental " or " ordinary and necessary expense " within the meaning of section 12 (a) of the Revenue Act of 1916.

The improvement is of a permanent nature. It was not an outlay for the maintenance of property. It is a capital asset from which the taxpayer will derive the benefit of increased pier facilities, resulting in increased revenues. That was the purpose for which it was built. The

beneficial result obtained therefrom will not be confined to one year, but many years. There is nothing in the language of the lease which would indicate in the slightest degree that the parties thereto contemplated a payment of rental of $1,500,000 in *one year*. On the contrary, the terms of the instrument show clearly that the rental is to be spread over the entire period of the lease. In fact, the lease did not provide for this expenditure in 1916, or in any one year. The fact that the pier was constructed in 1916 is no criterion upon which to base the conclusion that it was rental due for that year. But even if the leases involved had provided that these expenditures should be made in 1916, they would be payments for the continued use of the properties, not only for 1916, but for each succeeding year during the entire life of the leases, and would, therefore, have to be pro-rated.

In allowing deductions for rental, Congress undoubtedly intended that the rentals would only be deductible if the taxpayer was bound to make the payment in that year in order to obtain the continued use or possession of the demised premises. This is evidenced by the language used in section 12 (a), which reads:

> * * * including rentals or other payments *required* to be made as a condition to the continued use or possession of property. (Italics supplied.)

This language negatives any intent to allow deductions, other than for depreciation, for payments made in improving property or for capital expenditures, when such disbursements are merely made to accommodate the business of the taxpayer, as in case at bar.

Time is one of the fundamental facts in the taxation of incomes. The tax is laid upon income within a period of time. In this case from January 1 to December 31 of any given year. This same fundamental fact applies with equal force to deductions which Congress allows. They cover items of expenditure which are necessary in the maintenance of the taxpayer's business or property during the taxable period. It makes little difference whether it be for repairs or rent. Both income and deductions are computed upon a year's business. The income is not to be based upon one year's earnings and deductions therefrom upon a 10 or 15 year period *at the option of the taxpayer*. If it were so intended, undoubtedly Congress would have used unmistakable language in section 12 (a) to convey such an intent.

Read in the light of this construction of section 12 (a), which its language undeniably supports, article 140 of Regulations 33 (revised) is a reasonable regulation, affording as it does an equitable relief to a taxpayer who, for the purpose of

increasing his business capacity, makes extensive improvements upon leased property, by allowing a deduction for capital expenditures upon a prorated basis, which he otherwise would not be entitled to, unless the payment was *required* to be made in order to continue in possession of the premises. Moreover, this executive construction of section 12 (a), as shown by the regulations, was known to Congress when it enacted section 234 (a) of the Revenue Act of 1918, which is almost identical with section 12 (a) of the Revenue Act of 1916, and in effect constitutes a reenactment of that section. This reenactment, therefore, is an approval or ratification on the part of Congress of such construction. *United States* v. *Falk,* 204 U. S. 143; *United States* v. *Hermanos y Compania,* 209 U. S. 337; *Komada* v. *United States,* 215 U. S. 392; *National Lead Co.* v. *United States,* 252 U. S. 140.

This expenditure, however, partakes not of the character of rental but more in the nature of a *capital* investment. This is supported by the very terms of the lease, which provide that the city may terminate the lease at any time, in which event the taxpayer will be paid for this improvement. This is entirely inconsistent with the idea that the expenditures were made as rent, for if so then there would not be a provision for the return of such expenditures. In other words, the lease provides expressly for a return of "capital."

The Court of Appeals in its opinion has stated, "it is conceded by both parties that the expenditures for these improvements are 'additional rentals.'" This apparently is a mistake, for there is nothing in the agreed statements of fact which can be construed as conceding this to be the fact. But should it be determined that this expenditure of $1,545,865.54 is rental, it must be deducted upon a prorated basis as provided by article 140 of Regulations 33 (revised). It can not be allowed as a deductible item for the year in which the total expenditure was made.

It is said that this item constitutes "ordinary and necessary expense" or "rental" within the meaning of section 12 (a). It is hard to conceive how the phrase " to keep and maintain the premises and structures thereon, or to be erected thereon, in efficient repair and condition" can be construed to mean an expenditure of over a million and a half dollars in the erection and construction of the very premises that the plaintiff agrees to keep and maintain in good condition. The statement of the proposition is itself a refutation of such a contention.

This brings us to the two remaining leases and the items of expenditure made for additions and betterments upon the demised premises.

During 1916 the taxpayer was in possession of an extension to Pier No. 46, from the city of New York. The term of the lease expired October 25,

1924. The rental is 27½ cents per square foot per annum for the area of land under water covered by the extension. This lease provided that the taxpayer construct an extension to Pier No. 46 and a shed thereon under the direction of the city engineer. The property reverts to the city upon the termination of the lease. The costs of these improvements amounted to $14,486.22.

These improvements were not required under the terms of the lease to be made in 1916. Therefore, if the disbursements made therefor constitute rental, they are not deductible, except upon a prorated basis under article 140 of Regulations 33 (revised). The same is true with regard to the remaining lease, dated December 30, 1913, which runs for a term of 10 years, plus one extension of 10 years, and covers extension to Pier No. 39, North River, N. Y. This lease is very similar in terms to the other. The expenditure was for $6,003.78, the cost of an extension to Pier No. 39. The lease did not provide that this expenditure was to be made in 1916. In fact, the lease had been in force for nearly three years before this extension was constructed. This item can not be deducted except upon a prorated basis in accordance with article 140 of Regulations 33 (revised), if it be determined that it is rental.

The items expended for dredging, while small in amount, are controlled by the above principles. They have been held to constitute capital expend-

itures. *Ounsworth* v. *Vickers, Ltd.* (1915), 3 K. B. 267; *Dumbarton Harbour Board* v. *Cox* (1919), Scot. Cas. 162, 56 Scot. L. Reporter 122.

To avoid repetition, the argument on the question of what constitutes an "ordinary and necessary expense," made under heading I of this brief relative to the long-term leases, is adopted as applicable to the other leases considered above.

CONCLUSION

The judgment of the court below should be reversed.

JAMES M. BECK,
Solicitor General.

ALFRED A. WHEAT,
Special Assistant to the Attorney General.

NOVEMBER, 1924.

○

IN THE

Supreme Court of the United States

CHARLES V. DUFFY, Collector of Internal Revenue for the United States for the Fifth District of New Jersey, Petitioner, *v.* THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Respondent.	No.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

The petition filed in this cause prays for the issuance of a writ of certiorari to review a judgment of the Circuit Court of Appeals for the Third Circuit, affirming a judgment for $70,980.03 with interest, rendered in favor of the respondent Railroad Company by the United States District Court for the District of New Jersey in an action instituted to recover back a portion of the income tax assessed against it for the year 1916. The action was tried by the court without a jury on an agreed statement of facts. It was conceded that the Railroad was entitled to recover $37,781.54. Whether the balance of the judgment is right depends upon whether the Railroad Company was entitled to deduct from its gross income for the year 1916 the sum of $1,659,924.33, which it expended dur-

ing that year for (1) additions and betterments to leased railroads and branches; (2) construction of and extensions to piers; and (3) dredging at piers.

There is no dispute as to the facts which are set out in detail in the agreed statement of facts and in the opinion of the Court below. For present purposes it is sufficient to point out that these expenditures were made during the year 1916 to improve properties held under lease; that the Railroad Company had no equity in these properties, and that it had not taken or was not taking title to them; that the leases under which these properties were held required the Railroad Company to make the improvements and authorized the lessors to terminate them if the improvements were not made; and that under their terms title to the improvements when made vested in the lessors.

Both the District Court and the Circuit Court of Appeals held that the amounts so expended were rentals or other payments required to be made by the Railroad Company as a condition to the continued use or possession of property, and that it was entitled to deduct them from its gross income for the year in which they were made under the Revenue Act of 1916, which provides:

> "Sec. 12 (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—
>
> "First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to

> which the corporation has not taken or is not taking title, or in which it has no equity * * *."

The Government contends that the amounts so expended were capital expenditures, and cites *Grand Rapids & I. Ry. Co.* v. *Doyle*, 245 Fed. 792, and *Kemper Military School* v. *Crutchley*, 274 Fed. 125, which it asserts are in conflict with the decision below. Those cases, however, involved improvements made by a corporation to property which it owned and in them it was held properly that amounts expended for such improvements were not deductible from income. Here, however, the Government does not deny the right to deduct. It argues merely that the deduction should be spread over a period of years fixed either by the life of the improvement or the term of the lease, whichever is shorter.

In effect, the position taken by the Government is an effort to sustain Article 140 of the regulations promulgated under the Revenue Act of 1916 by the Commissioner of Internal Revenue (Regulations 33 Revised), which provides as follows:

> "*Article 140. Permanent Improvements Under Lease.* The cost of erecting permanent buildings or of making permanent improvements on ground leased by a company is held to be an additional rental and is therefore a proper deduction from gross income, provided such buildings and improvements, under the terms of the lease, revert to the owner of the ground at the expiration of the lease. In such case, however, the cost will be prorated according to the number of years constituting the term of the lease, and the annual deduction will be an aliquot part of such cost."

Since the right to deduct the expenditures involved here is conceded both in the argument advanced in this case and by the regulations adopted by the Commissioner of Internal Reve-

nue, the only question in the case is whether all of such expenditures made within the year may be deducted in that year, or whether they should be prorated over a term of years, as is contended for by the Government.

The solution of this question depends upon whether the regulation of the Commissioner of Internal Revenue is consistent with the express terms of the statute. If it is not, it must fall. *United States* v. *Morehead*, 243 U. S. 607, 613; *Maryland Casualty Co.* v. *United States*, 251 U. S. 342, 349; *International Railway Co.* v. *Davidson*, 257 U. S. 506, 514. On this point, the Court below said:

> "The statute expressly provided that all such rentals 'paid within the year' may be deducted 'from the gross amount of income received within the year' in order to ascertain the net income to be taxed. The evident intention of the statute is that the deduction of such rentals shall be made from the gross income *'within the year'* in which they are paid. *McCoach* v. *Minehill Railway Co.*, 228 U. S. 295, 304. There is no hint in the statute that they shall be prorated over the term of years of the lease. We think that the provisions of the statute are plain, but if there be doubt, that doubt must be resolved against the Government. *Gould* v. *Gould*, 245 U. S. 151. That part of the regulation providing that only an aliquot part of such rentals shall be deducted each year during the life of the lease, we think, is inconsistent with the plain provisions of the statute."

It is respectfully submitted that the decision of the Court below was right and that the petition for a writ of certiorari should be denied.

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